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THE NEED OF A CENTRAL BANK

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The financial panic and general suspension of cash payments by the banks of the United States, with the sudden paralysis of business resulting therefrom, did more to convince the people of the country that there were still serious defects in our currency system than all the arguments to that effect that had ever been made. Wall Street had been suffering from hard times since early in the year, quotations for securities had been going down but the prosperity of the country's industries seemed to be untouched. No doubt it was inevitable that such conditions in the security markets would eventually affect the industries, for when stocks and bonds are unmarketable the supply of capital for new enterprises is cut off. But a partial explanation for conditions in Wall Street was to be found in the glut of securities which had been poured out to support undertakings which are even yet uncompleted. The fact is that no recession in business was observable up to the date of the panic. The suspension of cash payments, the consequent inability of employers to obtain money for pay-rolls, the fright, and cancellation of orders, came on the general business community like a stroke of lightning from a clear sky. Since then few have disputed that currency reform is needed.

But there remains the difficult task of uniting public opinion upon some plan. Broadly speaking, three policies are proposed. First, a modification of our present system of bond-secured currency, by allowing, under a high tax, temporary, or emergency issues upon miscellaneous bonds. Second, the plan adopted by the American Bankers' Association, or something similar, allowing all national banks to issue credit notes against their general assets, secured only by a common guaranty fund. Third, the establishment of a central bank of large capital, which should exclusively perform the function of issuing credit notes to meet the varying needs of trade.

The first of these plans is confessedly a make-shift. Its advo-

cates do not claim that it should be accepted as a finality, but only that it is the best measure that can be enacted in the present unsettled state of public opinion. It would be inoperative in an emergency unless the banks set aside permanently a part of their resources for that class of investments, as a measure of insurance. They might do this, but it would be at a sacrifice of earning power, and effect a corresponding curtailment of the banking capital available for current use. Furthermore, the plan contemplates emergency issues solely, and there is no claim that they would be responsive to the ordinary fluctuations of trade.

The second plan, offered by the American Bankers' Association, is more comprehensive, and contemplates a genuine credit currency. It is, however, something of a compromise, the issues being limited to forty per cent of a bank's capital, and dependence against over-issue is placed in part upon this restriction, in part upon facilities for redemption and in part upon a graduated tax. Without going into an extended discussion of this plan, it may be said that it has never been tried under the conditions which exist in the United States, and the very restrictions imposed add something to the uncertainties. The success of the plan would depend upon the regularity and rapidity with which the notes were redeemed. The scheme itself contemplates that the self-interest of the individual banks will prompt them to return the notes of all other banks for redemption; but that is a practical working detail, the success of which, in view of the great number of banks outside the system, cannot be positively foretold. The state banking institutions would have no interest in promoting redemptions, as they are allowed to use the notes of national banks for reserves.

The first argument for a central bank is that such an institution, organized into, and made a part of, our national banking system, is needed to complete the latter, and all the more needed if important new powers as to currency issues are to be conferred upon the individual banks. The defects and weakness of the national system to-day are due to the isolation of, and lack of cohesion among, the great number of scattered units. The recent crisis has furnished ample demonstration of this. As a rule throughout the interior the banks had their usual supply of currency, but they restricted payments of cash, to the serious injury of business, not so much from fear that money would be hoarded by the public,

as from fear that it would not find its way back to the identical banks that paid it freely. For example, a bank which had the account of a railroad company might decline to supply money for its pay-rolls, because the large sum thus taken from it would be scattered along a thousand miles of line, and although it might replenish the reserves of other banks, there was no probability that any would come back to the original source. In like manner the absence of leadership and of common policy in the granting of credits resulted in a more precipitous contraction of these than was necessary. If contraction and liquidation are to be the order of things, everybody understands that there are certain advantages in being among the first to act, and so a crisis is accentuated by a disorganized scramble to force collections just when the interests of the country require judicious liberality in the matter of credits. If our banking system had at its head a strong institution, conservatively managed, and able to support any critical situation, it would practically make the policy of the whole system at such a time, for the individual banks would not feel that they stood isolated and alone and compelled to think only of self-preservation.

One result of the great number of small banks is that banking is not a trained profession, although it deserves to be. The bankers of the United States are a capable body of business men, but they have generally drifted into banking from some other occupation, without education in what is entitled to be regarded as a science—the science of the exchanges. No better proof of this is needed than the fact that so many of them see no reason why the notes of one bank should not be good in the reserves of another. This fact, that so large a proportion of the bankers of the country, although good judges of credits in their localities, and practically successful in the ordinary routine of their business, are not familiar with some of the fundamental principles of finance to which the country as a whole must conform, is a substantial reason why the national banking system should be surmounted by a supervisory institution. It is true that we already have a system of supervision through a public official, the Comptroller of the Currency, and there is no intention here of criticizing the administration of that office, which has usually been very good and is ably conducted at the present time. The Comptroller's supervision is largely exercised through his force of examiners, and the personnel of this force and

the character of its work have been constantly improving as political considerations have lost influence in the making of appointments. Nevertheless, there is inevitably a degree of formality and rigidity about such official supervision. The clearing-house associations of the larger cities have found it advantageous to establish their own system of examinations, and it is apparent that a central bank, which was a part of the system, and to which the individual banks were in the habit of applying for accommodations, would be able, through its examiners and by the information constantly coming to it through many channels, in the practical touch of business relations, to exercise a most efficacious and wholesome influence. This supervision would be particularly desirable if the note-issuing powers of the individual banks were to be enlarged. The central bank with its branches would then serve as the redemption agency through which the notes of the individual banks would be cleared or redeemed and through which the most active, effective and practical supervision of the note circulation would be maintained.

One of the features in which our banking system compares unfavorably with those of foreign countries is in the control of the interest rate. The natural and proper corrective of a tendency to over-expansion is a rising interest rate. It exercises a repressive influence, the pressure gradually increasing as the demand for credit enlarges, until the rate becomes high enough to curtail expansion. Some borrowers who want accomodations at five per cent will reduce their requirements when the rate reaches six, and some who will see a profit in using money at six, will drop out when the rate reaches seven. It is better to stop a runaway horse by heading him up a hill than by running him into a stone wall. In the one case he will get discouraged and slow down, while in the other there will be a smash-up. Under the competitive conditions which govern the banking business in the United States, the banks are accustomed to lend money to their depositors at practically uniform rates as long as they can make loans at all, and then abruptly shut down entirely. This is the smash-up policy. With a gradually rising rate the business man will hold in check any inclination to enlarge his liabilities and make an effort to reduce them, and he will have time to do so. There is an enormous difference to him between being obliged to pay high rates and not being able to get accommodations at all. By this policy the climax

of a boom period is rounded over, expansion checked and contraction brought about without the shock which is unavoidable where credit is supplied freely at a uniform rate until there is no loaning power left to be used. The uniform rate in this country is due to the competition of the banks for favor with depositors, and it is useless to expect any other policy to be followed unless a strong central bank becomes an important factor in the money market. Such an institution would have reserve powers for making loans after the individual banks were exhausted and when its aid was called for it would have control of the rate.

The foreign state banks are able to exert an important influence upon the movement of gold by means of the interest rate, an advance of the rate furnishing an inducement for the payment of gold upon obligations due the bank, and a reduction serving to relax its hold upon the metal. But even beyond this aid, in time of crisis the credit notes of a central bank may be allowed to flow out and take the place of gold in circulation, where the outgo of the latter is imperatively required, thus saving the industries of the country from shock. The Bank of France parts with important sums of gold for the relief of other countries without reducing the amount of its own notes in circulation, and hence without direct influence upon trade in France. Indirectly it protects and benefits conditions at home by helping to avert trouble in neighboring countries with which France is intimately related. In this country we lack the machinery for thus controlling the movement of gold or protecting our industries from injury when the basis of our system of credits is disturbed by conditions elsewhere.

The system of independent banks without a central organization is costly to the country in requiring an unnecessarily large gold reserve. In this respect the United States makes an especially poor showing of efficiency compared with Great Britain and a poor showing even when compared with the continental countries. The gold reserve of England is practically all in the Bank of England, and at the present writing is about $165,000,000. This is the capital by means of which the gold standard is maintained, and upon which the credits of the country rest, as other banks use Bank of England notes for their reserves. In the United States we have about $900,000,000 of gold in the treasury and some $250,000,000 or $300,000,000 in the banks. If this vast store of gold made

credits in this country more stable and secure than in England, there might be a valid argument for it, but our system has practically broken down twice in the last fifteen years, while a general suspension of cash payments in England is unknown. This gold reserve is a part of the country's capital, and the interest on it is a part of the cost of doing business in this country as truly as are our transportation charges. If the latter were higher than in foreign countries there would be great agitation about it. An examination of the situation in every other country will show that a central bank can be made to conserve and protect the gold reserves of a country and accomplish an important economy in this respect.

There is strong support for the central bank as a medium for the issue of an elastic currency in the experience and conclusions of foreign countries. One by one all of the other important countries of the world have adopted it. Even Switzerland, which had been served by twenty-six well-managed banks of issue, and where regulation by reason of the small area over which they were located, would seem to have been comparatively simple, in 1905 established a central bank to take over the function of issue. By centralizing the issues in one strong establishment, which in its organization is made a semi-official institution, this important function is performed not only immediately under the eye and with the participation of the government, but with complete publicity and subject to the criticism of the entire financial world. The weekly statements of the great state banks of foreign countries are scrutinized by the press and by economists, bankers, and critics of the whole world. Manifestly these conditions are radically different from those surrounding note issues by thousands of individual and unrelated banks scattered over such a country as the United States.

The central bank could amply meet the needs of every part of the country by rediscounting the bills receivable of local banks or loaning upon such collateral. The notes issued in making these loans would have behind them, first, the original borrowers; second, the endorsement of the local bank, and third, the responsibility of the central institution. The latter should have authority to examine local banks applying for loans, and by so doing would serve as an additional supervising authority over them and exert

a most salutary influence upon the whole banking situation. When fully organized the bank should have a dozen or so offices located in the more important cities of the different parts of the country, in order to be convenient of access for the local banks of all sections. Instead of being adapted only for times of panic, like most of the plans now offered, this system of note issues would be useful at all times and serve to equalize interest rates over the different seasons of the year, and to some extent over the different sections of the country. The notes of the central bank should gradually become an important part of the common circulating medium of the country, eventually taking the place of the present national bank circulation as the public debt is retired and increasing in volume with the growth of the country. They would be a more economical medium of exchange for the country than gold or gold certificates. They would not, like a recognized emergency currency, be in themselves a sign and symptom of financial trouble. As soon as country bankers were accustomed to the regular practice of rediscounting currency bills receivable and it became recognized as a perfectly legitimate method of aiding local customers, instead of being regarded as discreditable, the central institution would prove itself to be of great service to every part of the country, and particularly to those sections which produce the great agricultural staples but lack the free capital to handle them every year. They can furnish unquestionable security and the central bank could supply all the currency needed.

Let it be supposed that the capital of the central organization was fixed at $100,000,000. That would be only about 11 per cent of the capital of the banks in the national system, and of course the amount for them to raise would be much reduced if state banks were permitted to become shareholders. This capital might be invested in high-class bonds, as in the case of the Bank of France, thus serving simply as a guaranty fund. The central organization might then issue its notes for say $300,000,000, and through its constituent institutions exchange these for gold or gold certificates, thus establishing its gold reserve. If, now, it was authorized to issue notes upon the single condition that it should always keep a reserve equal to $33^1/_3$ per cent of the amount outstanding, it would have the capacity to put out $600,000,000 of uncovered notes. This would be the measure of elasticity obtainable upon a reserve of

$300,000,000. It might take some time to acquire that reserve, but as the stock of gold in the country increased, and as the central institution became in fact the recognized custodian of the country's reserves, it would become greater. A part of this note-issuing capacity could be in current use. In time it might acquire almost a monopoly of certain classes of commercial paper, notably that based upon staple commodities and secured by public warehouse receipts. It is in the annual movement of this class of commodities that the greatest fluctuations in the demand for money occurs, and the greatest need for elasticity is felt. The central institution could finance the movement for local banks without any disturbance to the money markets, and upon terms that would effect a saving to the producers. When the crop movement was over, and the loans based on the moving product were paid, the bank would be back to a liquidated condition and ready to expand again as its assistance was needed. With its power of note issue it would be able to liquidate any of its constituent institutions that required help. The method by which clearing-house certificates and checks were issued during the late crisis affords a complete illustration of the operations of such a system.

The usual objections to a central bank can be met in the organization. The opposing arguments in this country are usually based upon the experience of the old Bank of the United States and the political controversy which developed it. That bank was under strictly private management, entered into active competition with all state and private banks, and as the latter held no relation to it but that of competitors, it was not strange that opposition was fostered. Clearly, another central bank, if established, should be organized into the national banking system and be a part of it. The capital should be furnished by the individual banks and it should do business only with them. The stockholders should be represented in the management by a board of directors elected by territorial districts. By this system every section of the country would be represented on the board and likewise all shades of political opinion. The government should be represented in the control of the bank by the principal officers of the Treasury Department. The plan of the Bank of Germany where there are two boards, one chosen by the stockholders and one appointed by the government, has worked satisfactorily there. The combination of government authority with the

practical advantages that inhere in private ownership and management is thus secured. With such an organization, and the publicity that is necessarily given to the conduct of such an institution, the probability that it will be used to promote private or partisan interests is too remote to be seriously considered. The executive officers should be elected by the stockholders' board, but subject to approval by the government directors. The experience elsewhere is that trained bankers of known ability and the highest character are chosen.

Finally, all other plans for reforming our monetary system leave the relations of the United States Treasury to the money market precisely what they have been, and this furnishes one of the strongest reasons for preferring the central bank plan. In all other countries the receipts and disbursements of the treasury are handled by these institutions. The revenues go directly into the bank, the payments are checked out of it, and whatever surplus there may be remains in the bank, like any individual or corporate balance, subject to commercial use. With our independent treasury any surplus of revenues over expenditures remains in the vaults of the treasury until the Secretary volunteers, in his discretion, to deposit it in such national banks as he may select. During the fiscal year ended June 30, 1907, the government's revenue exceeded disbursements by the enormous sum of $87,000,000, and in order that this drain might not paralyze industry throughout the country, it was necessary for the Secretary to make deposits in this amount. The transactions of the treasury are increasing every year with the growth of the country, and the discrepancy between receipts and disbursements may reach very large figures. It is important that these sums be kept in circulation, but highly desirable that they be handled and distributed by an automatic system instead of by the voluntary and arbitrary action of the Secretary of the Treasury. The determination of when deposits shall be made, and in what cities and banks they shall be made, inevitably involves that official in the most unpleasant kind of criticism, and he should be relieved from it entirely by the adoption of a different system. At this writing the treasury deposits amount to about $250,000,000, scattered in 1,250 banks. During the last two months of 1907 the declining revenue receipts made it necessary for the treasury to replenish the working balances in its offices, but with financial conditions in a state of intense strain

it was impracticable to draw on the deposits and an issue of certicates of indebtedness was forced.

When all considerations are brought into the account it is found that a central bank answers the demands more completely than any other plan proposed. It is comprehensive and final, while other plans are incomplete and temporary. It is in harmony with the development of the times toward higher organization, and it has the advantage of being a working success elsewhere.